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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 646

THE NEW YORK, CHICAGO AND ST. LOUIS RAILROAD COMPANY,

Appellant,

vs.

COMMONWEALTH OF PENNSYLVANIA,

Appellee

STATEMENT AS TO JURISDICTION

In compliance with Rule 12 of the Supreme Court of the United States, as amended, The New York, Chicago and St. Louis Railroad Company submits herewith its statement of particulars disclosing the basis upon which the Supreme Court of the United States has jurisdiction on appeal to review the judgment of the Supreme Court of Pennsylvania entered in this cause on June 25, 1946. Petition for appeal was filed on September 24, 1946, and is presented to the Supreme Court of Pennsylvania, to wit, on September 24, 1946.

Jurisdiction

The jurisdiction of the Supreme Court of the United States to review by direct appeal the judgment entered in this cause is conferred by Section 237 (a) of the Judicial Code, as amended (Jan. 31, 1928, c. 14, Paragraph 1, 45

Stat. 54). The opinion in this cause was handed down by the Supreme Court of Pennsylvania on May 27, 1946, wherein was upheld the validity of a State statute which had been attacked as contrary to the Fourteenth Amendment of the Constitution of the United States. Petition for reargument was filed as required by Rule 86 of the Supreme Court of Pennsylvania, in cases to be appealed to the Supreme Court of the United States, and Order denying the petition was handed down by the Supreme Court of Pennsylvania on June 25, 1946, which is final and complete judgment in this cause by the highest tribunal of the Commonwealth of Pennsylvania. *Kansas City Southern Railway Co.* v. *Road Improvement District No. 3 of Sevier County, Arkansas,* 266 U. S. 379; *Miller* v. *Schoene,* 276 U. S. 272; *Citizens Bank of Michigan City* v. *Opperman,* 249 U. S. 449.

Statutes Involved

The sections of the statutes of the Commonwealth of Pennsylvania involved are quoted below. Only the constitutionality of the limitation on the exemption of mutual savings banks is attacked, the limitation and exemption being italicized.

1. Sections 17 and 18 of the Act of the Commonwealth of Pennsylvania, approved May 18, 1937, P. L. 633, as amended by the Act of the Commonwealth of Pennsylvania, approved May 5, 1939, P. L. 46, as follows:

> "Section 17. State Tax on Scrip, Bonds, Et Cetera; Imposition and Rate of Tax.—All scrip, bonds, certificates, and evidences of indebtedness issued, and all scrip, bonds, certificates, and evidences of indebtedness assumed, or on which interest shall be paid by any and every private corporation, incorporated or created under the laws of this Commonwealth, or the laws of any other state or of the United States and doing business in this Commonwealth and having a resident

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corporate treasurer therein, except first class or non-profit corporations, are hereby made taxable for State purposes at the rate of eight mills on each dollar of the nominal value thereof, during the calendar years one thousand nine hundred thirty-eight, (and) one thousand nine hundred thirty-nine, one thousand nine hundred forty, and one thousand nine hundred forty-one, on reports filed for the calendar years one thousand nine hundred thirty-seven, (and) one thousand nine hundred thirty-eight, one thousand nine hundred thirty-nine, and one thousand nine hundred forty, or for any fiscal year beginning in the calendar years one thousand nine hundred thirty-seven, (and) one thousand nine hundred thirty-eight, one thousand nine hundred thirty-nine, and one thousand nine hundred forty, and at the rate of four mills on each dollar of the nominal value thereof during the calendar years one thousand nine hundred (forty) forty-two, and every year thereafter, on reports filed for the calendar years one thousand nine hundred (thirty-nine) forty-one, (or for any fiscal year beginning in the calendar year one thousand nine hundred (thirty-nine) forty-one, and for every year thereafter; and all scrip, bonds, certificates and evidences of indebtedness issued and all scrip, bonds, certificates and evidences of indebtedness assumed or on which interest shall be paid by any county, city, borough, township, school district or incorporated district of this Commonwealth, are hereby made taxable for State purposes at the rate of four mills on each dollar of the nominal value thereof during the calendar year one thousand nine hundred thirty-eight, and every year thereafter, on reports filed for the calendar year one thousand nine hundred thirty-seven, or for any fiscal year beginning in the calendar year one thousand nine hundred thirty-seven, and for every year thereafter: * * * Provided, That this section shall not apply to bank notes or notes discounted or negotiated by any bank or banking institution, savings institution or trust company, nor to interest-bearing accounts in any bank, banking institution, savings institution, employes' thrift or savings association, whether

operated by employes or the employer, or trust company: *And provided further, That the provisions of this act shall not apply to building and loan associations or to savings institutions having no capital stock, and if at any time either now or hereafter, any persons, individuals, or bodies corporate have agreed or shall hereafter agree to issue his, their or its securities, bonds or other evidences of indebtedness, clear of and free from the tax, or any part thereof, provided for in this act, or in the act approved the seventeenth day of June, one thousand nine hundred thirteen (Pamphlet Laws, five hundred seven), or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt him, it or them, from paying the tax imposed herein on any of such securities, bonds, or other evidences of indebtedness, as may be held, owned by, or owing to, the said savings institution having no capital stock:* And provided further, That the provisions of this act shall not apply to fire companies, firemen's relief associations, life or fire insurance corporations having no capital stock, secret and beneficial societies, labor unions and labor union relief associations, and all beneficial organizations paying sick or death benefits, or either or both, from funds received from voluntary contributions or assessments upon members of such associations, societies, or unions: And provided further, That corporations, limited partnerships, and joint-stock associations, liable to tax on capital stock for State purposes, shall not be required to pay any further tax, under this section, on the mortgages, bonds, and other securities owned by them in their own right; but corporations, limited partnerships, and joint-stock associations holding such securities as trustees, executors, administrators, guardians, or in any other manner, except as executor or administrator of the estate of a nonresident decedent, and except as trustee for a resident or nonresident religious, charitable or educational organization, no part of the net earnings of which inures to the benefit of any private stockholder or individual, shall be liable for the tax imposed by this section upon all

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securities so held by them as in the case of individuals: And provided further, That none of the classes of property made taxable by this section for State purposes shall be taxed or taxable for county, school, or other local purposes: And provided further, That the provisions of this section shall not apply to personal property, of the classes hereinabove enumerated, received from any person or persons, copartnership or unincorporated association, or company, nonresident in or not located within this Commonwealth, or from any joint-stock association, limited partnership, bank or corporation formed, created, or incorporated by, under, or in pursuance of any law of the United States, or of any state or government other than this Commonwealth, by any person or persons, copartnership or unincorporated association resident in this Commonwealth, company, joint-stock company or association, limited partnership, bank or corporation created or existing under the laws of this Commonwealth or doing business within this Commonwealth as active trustee, agent, attorney-in-fact, or in any other capacity for the use, benefit or advantage of any person or persons, copartnership or unincorporated association, or company nonresident in, or not located within, this Commonwealth, or for the use, benefit or advantage of any joint-stock company or association, limited partnership, bank or corporation formed, created or incorporated by, under, or in pursuance of any law of the United States, or of any state or government other than this Commonwealth; or any such property whatsoever owned, held or possessed by any person or persons, copartnership or unincorporated association resident in this Commonwealth, company, joint-stock company or association, limited partnership, bank or corporation created and existing under the laws of this Commonwealth or doing business within this Commonwealth in the capacity of executor or administrator of a nonresident decedent, or as trustee, agent or attorney-in-fact for any resident or nonresident religious, charitable, scientific, literary or educational organization, no part of the net earnings

of which inures to the benefit of any private stockholder or individual. * * *"

"Section 18. Reports and Payments of the State Tax by Private Corporations and Municipalities.—(a) It shall be the duty of the resident treasurer of each private corporation, incorporated by or under the laws of this Commonwealth or the laws of any other state or of the United States or any foreign country, and doing business in this Commonwealth, except nonprofit corporations and cooperative agricultural associations not having capital stock and not conducted for profit, and it shall be the duty of the treasurer of each county, city, borough, township, school district or incorporated district of this Commonwealth, upon the payment of any interest on any scrip, bond, certificate or evidence of indebtedness issued or assumed by such corporation, county, city, borough, township, school district or incorporated district, or upon which it is liable for the payment of the interest to residents of this Commonwealth and held by them, to assess the tax imposed for State purposes by the seventeenth section of this act, upon the nominal value of each such scrip, bonds, certificates or evidences of indebtedness, and to report, under oath or affirmation, annually, on or before the fifteenth day of March, for the calendar year next preceding, to the department, the amount of such indebtedness owned, held or in any manner possessed by residents of this Commonwealth, together with such information as the department may require: Provided, That such scrip, bonds, certificates and evidences of indebtedness shall be deemed to be owned, held or possessed by residents of this Commonwealth, unless it is established that they are not so owned, held or possessed, and it shall be his further duty to deduct the tax, imposed by the seventeenth section of this act, on the payment of any interest upon such indebtedness and return the same to the State Treasury, through the department, within the time prescribed by law, and his compensation for his services shall be five per centum on the first one thousand dollars ($1,000.00), or frac-

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tional part thereof, one per centum on all amounts over one thousand dollars ($1,000.00) and not over two thousand dollars ($2,000.00), and one-half of one per centum on all amounts over two thousand dollars ($2,000.00). Upon the payment of said State tax, such scrip, bonds, certificates or evidences of indebtedness shall be exempt from all other taxation in the hands of the holder of the same.

"The time for filing reports may be extended, taxpayers may be permitted to file their reports on a fiscal year basis, and the procedure and penalties in case of failure to report and pay the tax shall be as prescribed by law.

"(b) It is the intent and meaning of this act that the tax for State purposes, imposed upon obligations of private and public corporations by section seventeen of this act, shall be collected in the same manner as the tax heretofore imposed for State purposes upon such obligations."

The Issues and the Ruling Below

On April 17, 1944, The New York, Chicago and St. Louis Railroad Company filed with the Court of Common Pleas of Dauphin County, its appeal from the Order of the Board of Finance and Revenue denying petition for review of settlement of the Corporate Loans Tax for the year 1941 in the sum of $26,865.41 on securities issued by the Railroad Company. A number of issues not pertinent to this appeal are raised in the appeal to the Court of Common Pleas of Dauphin County. The issue related to this appeal is contained in Paragraph 1 of the Specifications of Objections of the appeal to the Dauphin County Court, and complains of tax settled at the rate of eight mills for one year on $456,000 par value of appellant's securities held by mutual savings banks without capital stock incorporated in Pennsylvania, resulting in violation of Section 1, Article IX of the Constitution of the Commonwealth of Pennsylvania requiring

uniform taxation, and in arbitrarily and capriciously depriving the appellant of property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States, and impairment of contract in violation of Article I, Section 10, Clause 1 of the Constitution of the United States.[1] The Corporate Loans Tax in Pennsylvania is a tax levied upon bonds and other securities and evidences of debt held by residents of Pennsylvania and issued or the payment assumed by Pennsylvania corporations and by corporations doing business in Pennsylvania. From 1891 until 1935 it was a four mill tax upon the par value of the bonds. In 1935 an Act was approved adding an additional mill, and in 1936 this Act was amended to all four mills instead of one mill, making the total tax eight mills. The present Act under which the 1941 tax was assessed was adopted in 1937, amended in 1939 and effected little change in the 1935 and 1936 Acts.

The tax is assessed and collected by the Treasurer of the corporation at the time interest is paid. If no interest is paid no tax is assessed or collected. By the decision of the Supreme Court of Pennsylvania in this case the corporation is construed to be the assessor and collector of the tax and this construction is not here questioned.

By the Act of the Commonwealth of Pennsylvania, approved May 1, 1909, P. L. 198, mutual savings banks without capital stock were added to the exempt classes of holders of otherwise taxable securities and evidences of debt with the proviso: "and if at any time, either now or hereafter, any persons, individuals or bodies corporate have agreed or shall hereafter agree to issue *his, their or its* securities, bonds or other evidences of indebtedness clear of and free from the said four mills tax, herein provided for, or have agreed or shall hereafter agree to pay the same, nothing

[1] Page 7a Printed Record in Supreme Court of Pennsylvania.

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herein contained shall be so construed as to relieve or exempt him, it or them from paying the said four mills tax on any of the said such securities, bonds, or other evidences of indebtedness, as may be held, owned by or owing to said savings institution having no capital stock."

This proviso was continued in effect until the Act of 1937 when a material change occurred as follows:

> "and if at any time either now or hereafter, any persons, individuals, or bodies corporate have agreed or shall hereafter agree to issue his, their or its securities, bonds or other evidences of indebtedness, clear of and free from the tax, or any part thereof, provided for in this act, or in the act approved the seventeenth day of June, one thousand nine hundred thirteen (Pamphlet Laws, five hundred seven), or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt him, it or them, from paying the tax imposed herein on any of such securities, bonds, or other evidences of indebtedness, as may be held, owned by, or owing to, the said savings institution having no capital stock:"

The obvious purpose of this proviso was to continue in force the obligation of the corporation issuing the bond to pay the tax which it had agreed to pay for the taxpayer. The holder of the bonds was exempted. The issuer of the bonds continued to pay the holder's tax. "A's" tax was imposed upon "B". The debtor had to pay the creditor's tax from the payment of which the creditor had been excused.

Since, however, the Corporate Loans Tax had been and still is uniformly held by the courts of Pennsylvania to be a tax upon property (*Commonwealth of Pennsylvania* v. *Lehigh Valley Railroad Company*, 104 Pa. 89; *Commonwealth* v. *Lehigh Valley Railroad Co.*, 186 Pa. 235, 246, 40 A. 491, 492; *In re Wyoming Valley Ice Co.*, 145 F. 267; *Com-*

monwealth v. *Jessup & Moore Paper Co.*, 31 Dauph. 273; *Commonwealth* v. *Safe Harbor Water Power Corporation*, 43 Dauph. 415) both the lower court and the Supreme Court of Pennsylvania in the case of *Commonwealth* v. *Lehigh Valley R. R. Co.*, 244 Pa. 241, 90 A. 564, did not accept the obvious purpose of the proviso. Instead they held that the tax remained upon the tax-free-covenant bonds in the hands of mutual savings banks without capital stock in Pennsylvania, while exempting bonds in the hands of mutual savings banks without capital stock, which did not contain such covenant. Thus, the mutual savings banks without capital stock held two classes of bonds, one taxable and the other not taxable. The obligation of the corporation to pay the tax referred to in the proviso was its obligation as collector of the tax for the Commonwealth, and not the obligation imposed by its covenant. The covenant merely tagged the bond for classification. Since the tax remained on the bond, the covenant to pay the tax was kept active. The amendment to the proviso in the Act of 1937 was probably intended to bring its wording more in conformity with the interpretation put on the proviso in the first Act by the Supreme Court (*Commonwealth* v. *Lehigh Valley Railroad Company, supra*).

Certain corporations in their covenants limited the amount of tax they would pay to four mills, while other corporations placed no limit on the amount of Corporate Loans Tax they would pay on behalf of the holder of the bonds. When the Act of 1936 was passed adding four mills to the four mills already imposed, the Commonwealth, under the construction placed upon the Act by the Supreme Court of Pennsylvania requiring the corporations which agreed to pay only four mills of such tax to collect the additional four mills from the mutual savings banks without capital stock, should have collected the additional tax on bonds

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with tax-free covenants. This the Commonwealth refused to do and limited the payment of the tax on such bonds to the four mills which the corporations had agreed to pay.[2] This policy of the Commonwealth was continued under the Act of 1937 and its amendments.

Because the appellant had a covenant to pay whatever tax might be imposed, the Court of Common Pleas of Dauphin County in the instant case sustained in full the eight mills of tax imposed on $456,000.00 of appellant's securities held by mutual savings banks without capital stock containing tax-free-covenant clauses. It dismissed the attack on the constitutional validity of the proviso imposing the tax, by referring to a companion case wherein is the simple statement that it was in the power of the Commonwealth to impose the tax, citing the case of *Commonwealth* v. *School District of Pittsburgh*, 343 Pa. 394, which had upheld the authority of the earlier case of *Commonwealth* v. *Lehigh Valley R. R. Co., supra.*

The appellant took an exception to this conclusion of the Court of Common Pleas of Dauphin County as follows:

> "9. The learned trial judge erred in failing to conclude that the imposition of liability upon the defendant to pay over the corporate loans tax involved in this case unconstitutionally deprived the defendant of its property without due process of law and denied to it the equal protection of the law."[3]

The appellant also took exception to the finding of the trial judge that the defendant was liable for the tax on its tax-free covenant bonds held by Pennsylvania mutual savings institutions having no capital stock. The court overruled the exceptions. The appellant also took exception to the

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[2] Page 77a Printed Record in Supreme Court of Pennsylvania.

[3] Page 79a Printed Record in Supreme Court of Pennsylvania.

judgment of the trial judge sustaining settlement of the tax. Both exceptions were overruled.[4]

The overruling of the exceptions was assigned as error in an appeal taken to the Supreme Court of Pennsylvania.[5] It sustained the judgment of the Court of Common Pleas of Dauphin County in the matter involved in this appeal as well as on other points. In the matter of the constitutional validity of continuing the tax on tax-free-covenant bonds of the appellant held by mutual savings banks without capital stock, it contented itself with referring to the two cases in which the point had already been settled—*Commonwealth* v. *Lehigh Valley R. R. Co., supra,* and *Commonwealth* v. *Pittsburgh School District, supra.*

It is the contention of The New York, Chicago and St. Louis Railroad Company that:

1. The continuing in force of the obligation of the appellant below under the tax-free-covenant clauses in bonds held by mutual savings banks without capital stock compels appellant below to pay a tax on property not owned by it but owned and held by mutual savings banks without capital stock, thereby depriving appellant below of its property without due process of law and denying to it the equal protection of the law contrary to the Fourteenth Amendment of the Constitution of the United States.

2. The construction of the proviso of the taxing statute by the Supreme Court of Pennsylvania whereby bonds, securities and other evidences of debt held by mutual savings banks without capital stock are placed in two classes—those containing no tax-free-covenant clauses and those containing tax-free-covenant clauses—is arbitrary and

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[4] Pages 79a and 80a Printed Record in Supreme Court of Pennsylvania.

[5] Pages 3 and 4 Printed Brief of Appellant in Supreme Court of Pennsylvania.

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capricious classification in that while non-tax-free-covenant bonds in the hands of mutual savings banks without capital stock are exempt from tax, tax-free-covenant bonds continue to be subject to tax solely for the purpose of keeping active for the benefit of the Commonwealth, a covenant which existed only for the benefit of the holder of the bonds. The appellant below is thereby denied the equal protection of the law and deprived of property without due process of law, contrary to the Fourteenth Amendment of the Constitution of the United States.

The Questions Are Substantial

The questions submitted in this appeal are substantial and important. Aside from the amount of tax at stake, which is considerable, there is the principle involved of whether or not a State may arbitrarily use the power of classification of property solely for the purpose of nullifying a right under the Federal Constitution.

In this case the Legislature of Pennsylvania exempted from the corporate loans tax of that State corporate bonds held by mutual savings banks without capital stock located in the State. Quite a number of classes of holders of bonds exempt from the tax had been established, and no exception is taken to classifying these banks for purposes of tax exemption. They are founded to enable people of few means to secure a better return on their savings than is elsewhere available while retaining all the usual safeguards. They have many cooperative features. They are an object of special regard of the State.

The objection of the appellant comes when the State taxes corporate bonds with tax-free-covenant clauses in the hands of these tax exempt savings banks without capital stock and imposes the tax on the issuer of the bonds. The covenant of the issuing corporation had become dormant.

To compel the covenantor now to pay the tax was compelling it to do more than it had agreed to do.

On its face, this imposes a property tax on property not owned. The property, corporate bonds, are owned by the mutual savings banks. The tax is paid by the issuing corporation, a party who has no title to the bonds. The Legislature apparently had seized upon the fact that the obligor of the bonds had some relationship to them and thereby attempted to impose the tax upon it. But the obligor has no property interest in its own obligations. The obligee owns the obligations. The dangerous doctrine is established that the State may impose upon the debtor a tax properly due and owing by the creditor, but no similar attempt has been made by any other State or by the Federal Government so far as can be found.

It has been settled that the State cannot tax "B" for the property owned by "A". *Schlessinger* v. *State of Wisconsin,* 270 U. S. 230; *Hoeper* v. *Tax Commission,* 284 U. S. 206; *Heiner* v. *Donnan,* 285 U. S. 312.

The dissent in the cases just cited did not in any way attempt to deny the rule that the State could not collect taxes against "B" on property owned by "A". That proposition has never been doubted.

The Pennsylvania Supreme Court has tried to get around this unconstitutional taking of property, by construing the taxing Act to set up two classes of bonds in the portfolios of the mutual savings banks without capital stock, those without tax-free covenants being exempt and those with tax-free covenants being subject to the tax. Mark you, the tax-free-covenant bonds are taxed in the hands of and as the property of the mutual savings banks under this construction. This keeps alive the covenant of the issuer of the bonds in the eyes of the Pennsylvania courts. The issuer being bound, must pay the tax. Thus is avoided the em-

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barrassment of saying that "B" is being taxed for property of "A". A borrower, foolishly or otherwise, in order to secure funds, promises the lender to pay any taxes that are levied on the obligation. The State exempts the lender from paying tax, except tax on obligations which the debtor has agreed to pay. Such obligations in his hands are classified by the agreement to pay the tax in order to keep alive the agreement to pay the tax.

It is insisted that "B" is still being taxed for property of "A", despite the construction of the Supreme Court of Pennsylvania. While the Supreme Court of the United States considers itself concluded by the ordinary construction of a statute by the State court of last resort, in a question of whether a tax statute deprives a party of rights secured by the Federal Constitution, it does not look to the form in which the taxing scheme is cast nor to the characterization of that scheme as adopted by the State court. The operation and effect of the tax, the substance and not the form is considered. *St. Louis Southwestern Railway Company* v. *Arkansas ex rel. Norwood,* 235 U. S. 350, 362, 363; *Senior* v. *Braden,* 295 U. S. 422, 429; *Schuylkill Trust Co.* v. *Commonwealth of Pennsylvania,* 296 U. S. 113, 119.

When the Commonwealth of Pennsylvania raised the corporate loans tax from four mills to eight mills it did not, in the case of an issuer of bonds who had agreed to pay only four mills of tax for the holder, collect the additional four mills from the mutual savings bank without capital stock which held the bonds. This it should have done under the ruling of the Pennsylvania courts. It disregarded the ruling and contented itself with collecting only four mills from the issuer of the bonds, itself. This disregard is particularly flagrant under the amendment of the proviso in the Act of 1937 and its amendment which specifically im-

poses the tax regardless of the amount of tax which the covenant agrees to pay.

It is respectfully submitted that real and substantial questions are presented in this case.

ROBERT M. FISHER,
JOHN Y. SCOTT,
Counsel for The New York, Chicago and St. Louis Railroad Company.

This 24th day of September, 1946.

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